



COMMONWEALTH of VIRGINIA

Office of the Governor

Robert F. McDonnell
Governor

April 2, 2013

William H. Fralin, Jr.
Chairman
Virginia Port Authority Board of Commissioners
600 World Trade Center
Norfolk, VA 23510

Dear Chairman Fralin:

Thank you for your recent update on the status of the Public-Private Transportation Act (“PPTA”) proposal evaluation process and the Board of Commissioner’s recommendations for continuing our mutual goal of ensuring the Port of Virginia is the leading cargo facility on the East Coast. Let me begin by first thanking you and the Board for all of your hard work and efforts in what has been a challenging past two years for the port.

Over the past week, our Administration has been reviewing the Board’s recommendations and analysis of the PPTA proposals submitted by APM Terminals, Inc. and Virginia Port Partners. Those recommendations include: moving forward with a corporate restructuring of the Virginia International Terminals, Inc. (“VIT”)/Virginia Port Authority (“VPA”) relationship; immediately commencing a global search for a permanent Executive Director and senior staff; terminating the PPTA proposal evaluation process; and, developing a long-term strategic plan for addressing the broader, non-operational challenges facing the Port of Virginia.

By way of background, my first year in office I replaced all but one of the Board’s commissioners due to an evaluation of the Port’s performance and finances, and our desire to make the Port more competitive and efficient. Over a year ago, the Port received an unsolicited PPTA proposal from the international port and shipping company APM to operate the port. It was a credible multibillion dollar proposal that needed further evaluation, so the next steps were taken to see if other companies might bid. Several other proposals were received, and we asked the current operator, VIT, to submit their own proposal on continuing to operate the Port.

Over the past 10 months, the Board and the Secretary’s office have conducted extensive evaluations of the finances of these proposals, and the merits of changing management versus keeping the status quo. You have now determined that selecting a restricted and improved VIT with new management is the best alternative for the Commonwealth at this time.

When the PPTA evaluation process began, I was clear that I wanted you to use your best independent business judgment on which proposal served the people and the Port's interest the best; I also conveyed to you that the initial independent decision-making authority on whether or not to recommend a private concession for port operations was vested in the Board. Throughout the process, Secretary Connaughton and his team have updated me on your progress and have worked closely with the Board and our consultants to evaluate the proposals. After reviewing the information you provided last week and discussing your analysis with the Secretary, I accept the Board's decision, provided that the Board take the actions I outline below.

In making your decision, the VPA Board relied on many assumptions from the VPA's updated 2040 Master Plan, including revenue projections, cargo volume growth forecasts, and operating expense projections. This data was then built into a Public Sector Comparator ("PSC") used to evaluate the net cash flow generated by a concession compared to the net cash flow generated by VIT over the next 48 years. The results of the PSC showed that retaining VIT could provide more cash flow on a net present value basis for the VPA than would a concession.

To achieve the financial performance projected by the PSC, the VPA and VIT must increase efficiency and reduce operating costs while increasing container volumes and revenues. Your letter is very clear on this point, as it notes:

"It is imperative that the Board, VPA management, and VIT continue to address these cost control, operational efficiency, and management issues. Despite having the second highest growth year on record, the Port is still projected to suffer another operating loss in FY 2013. These losses are unacceptable, and, if unaddressed, will continue to negatively impact the Port's ability to attract and retain new customers."

Over the next five years, the PSC assumes that the VPA and VIT will grow revenues by an average of 7.3%, which equates to an average of \$27.8 million per year. This increase in revenues is driven by cargo growth at a rate of 5.8% per year, and a reduction in maintenance and operating expenses of approximately \$14 million per year over the same five year period.

I raise this point to stress the importance of the Board addressing the short and long-term challenges facing the port, as you spelled out in detail in your letter. In the short-term, the challenges include quickly implementing the corporate restructuring of the VPA and VIT in order to reduce costs, eliminate duplication of effort, and improve operational oversight. In the long-term, they include the development of Craney Island, incentivizing and attracting distribution and other facilities, off-terminal infrastructure improvements, better coordination of economic development efforts, dual access rail service, improving the port's financial picture to reduce dependence on state funding, and determining the appropriate role for the private sector in the future, among other things.

In the face of these challenges, the Board must move quickly to implement the multiple well-designed recommendations contained in your letter, and my acceptance of the Board's

decision to terminate the PPTA proposal evaluation process is contingent upon the Board doing so. Specifically, the following actions, many of which you outline in your letter, must be implemented in a timely manner.

First, it is imperative that the Board install permanent leadership at the VPA. The interim management team has done a tremendous job, but tackling the challenges facing the port will require a permanent and strong leadership team with the global connections necessary to attract economic development opportunities and grow cargo volumes. While the corporate restructuring and development of the strategic plan must begin immediately, it is important that this team be in place as soon as possible to oversee these critical initiatives.

Second, the Board must immediately follow through on implementing the corporate restructuring and developing the strategic plan. The VPA cannot meet the targets outlined in the updated 2040 Master Plan without significant reductions in costs, increases in revenue, and growth in cargo volumes, as you correctly note in your letter. The necessary reductions in cost cannot be achieved without an effective and timely reorganization of the VIT/VPA relationship. Further, while the restructuring will address short-term operational challenges, the strategic plan for dealing with the long-term challenges must be in place for the port to improve its financial outlook and grow cargo volumes into the future. The Port reform bill I worked on with the legislature, and I hope will be amended accordingly tomorrow, will give you further tools to achieve the reorganization, along with certain administrative powers you already possess.

Third, as part of the corporate restructuring, the comprehensive audit of VIT referenced in your letter must occur. We have had much success with such audits of other state agencies. It would be inappropriate for a state entity to assume all operational liabilities of what is technically a private entity (VIT) without first conducting such a review. Equally important, this audit may help identify additional ways to improve performance and reduce costs.

Fourth, I would request a detailed plan for how the Board and the VPA management expect to meet the targets outlined in the updated 2040 Master Plan, and implement the rest of the excellent recommendations outlined in your letter. Lastly, it is critical that we continue the open dialogue between the Board and the Administration as the Board moves to implement its recommendations. Therefore, I would request ongoing updates from the Board on its progress in implementing its plans.

The Port of Virginia is one of the Commonwealth's most important and valuable economic assets. With our 50-foot deep channel, post-Panamax class cranes, access to two Class I railroads, and ability to expand terminal capacity, Virginia is in a unique position. We have the only port on the East Coast capable of handling the ever increasing size of cargo vessels utilizing the Suez Canal and soon-to-be-completed Panama Canal expansion, and we have a tremendous opportunity to seize upon the projected growth in the East Coast container business. However, we must continue to address the challenges facing our port in order to capitalize on these strategic advantages. These past years have been, as the next few will be also, a time of historic

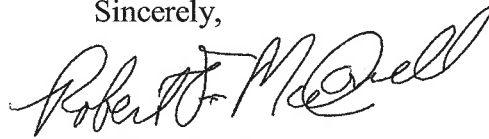
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reform and restructuring for the Port that I am hopeful will be the catalyst for robust future growth for our people.

Again, I thank you, the Board, and the VPA management and staff for your continued significant efforts to reform the Port of Virginia and return it to profitability. Working together, we have made much progress in my charge to you that we make the port the leading cargo facility on the East Coast. I look forward to continuing our efforts throughout the remainder of my administration.

Should you wish to further discuss this or any other matter, please do not hesitate to contact Secretary Connaughton or myself at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert F. McDonnell", written in a cursive style.

Robert F. McDonnell

Cc: Secretary Sean T. Connaughton
Commissioners, Virginia Port Authority